

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

495.0493

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition)	
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
Q--- COMPANY)	No. SY DH XX-XXXXXXX-030
)	
)	
<u>Petitioner</u>)	

The Appeals conference in the above-referenced matter was held by Staff Counsel Lucian Khan on May 10, 1994 in Fresno, California.

Appearing for Petitioner:

P--- L---
Vice President
Finance & Administration

J--- K---
Attorney at Law

Appearing for the
Sales and Use Tax Department:

Bud Jones
District Principal Auditor

Charles Tavookjian
Supervising Tax Auditor

Protested Items

The protested tax liability for the period April 1, 1988 through March 31, 1991 is measured by:

	<u>Item</u>	<u>State, Local and County</u>
A.	Claimed out-of-state sales disallowed	
1.	Lease receipts on wheel loader #063X08095	\$176,000
2.	Wheel loader #063X09139	\$270,765
3.	Sale of scraper #06YF00159	\$295,454

Contentions

1. The lease receipts on the first piece of equipment (#063X08095) was not taxable because the lessee did not take possession of the property.
2. Although the purchase options were exercised on the other two pieces of equipment, it would not be considered a sale, since the buyer never took title or possession.
3. If it is determined a taxable lease or sale(s) occurred, petitioner is entitled to a returned merchandise credit.

Summary

Petitioner is a [name] equipment dealer involved in the sales, leasing, and repair of new and used equipment. In an audit covering the above period, the Sales and Use Tax Department (SUTD) auditor assessed tax on transactions relating to three pieces of equipment. In each instance, the lessee/ purchaser was W--- C--- C--- (W--- C---) or its related entity, M--- R---, located in [city], California. Details of the transactions are as follows:

1. Wheel loader serial number 063X08095

In approximately January 1988, petitioner entered into a lease agreement with W--- C---. Although W--- C--- never took possession during the term of the lease, it paid a total of \$176,000, at the rate of \$11,000 per month. The agreement provided a purchase option, but it was never exercised. The \$176,000 was later applied towards the purchase of a second piece of equipment (see transaction #2 below), and this wheel loader was resold to another purchaser. A copy of the lease agreement has not been submitted.

2. Wheel loader serial number 063X09139

This transaction also involves a lease agreement with W--- C---, entered into on February 21, 1990. On July 11, 1990, M--- R--- exercised the purchase option, and petitioner applied the \$55,000 paid in lease receipts on this equipment, and the \$176,000 paid in transaction #1, against the purchase price. It was intended that the equipment be delivered to Oregon (see Exhibit 1 attached); however, delivery was never made. The equipment always remained at petitioner's place of business and is currently available for sale.

3. Scraper serial number 06YF00159

This transaction involves another lease agreement with W--- C---, entered into on June 1, 1990. The agreement provides for monthly payments of \$14,000 and contains a purchase option. On January 21, 1991, the option was exercised, and petitioner applied the \$112,000 paid in lease receipts, towards the purchase price. As above, it was intended that the scraper would be delivered to Oregon; however, delivery was never made during the term of the lease or when the option was exercised. The equipment remained at petitioner's place of business until April 7, 1994 at which time it was sold to a purchaser named R--- T--- Company, for \$325,000. On April 26, 1994, petitioner issued a check made payable to W--- C--- in the amount of \$250,893 (apparently as a refund).

Petitioner argues that no sales tax is due in transactions #2 and #3 because the equipment was not sold to either W--- C--- or M--- R---. In support of its position, petitioner references Revenue and Taxation Code Section 6006(a) which defines a "sale" as a transfer of title or possession, and Uniform Commercial Code Section 2401, which provides that title passes upon delivery of the goods to the buyer. It is uncontroverted that the equipment was never delivered, and remained on petitioner's premises at all times. Petitioner asserts that because there was no transfer of possession or title in either transaction, a sale did not occur. However, if it is found that sales did take place, then it is petitioner's position that the provisions of Sales and Use Tax Regulation 1655 (returned merchandise) should apply, because the amounts paid were ultimately credited or refunded to W--- C---/M--- R---. Petitioner also disputes whether a lease (transaction #1) in fact took place. Under Regulation 1660(a)(1), a "lease" is defined as a contract where tangible personal property is "operated by, or under the direction and control of, the person or his employees". Since the property was never used or operated, there was no lease.

As to the lease issue, SUTD argues that Revenue and Taxation Code Section 6006.1 provides that the granting of possession by the lessor to the lessee is a continuing sale by the lessor, and Regulation 1628(b)(3)(B) specifically provides that when the sale is by lease, the sale occurs upon the transfer of possession or granting of the right of possession of the property by the lessor to the lessee or other person at his direction.

As to the two transactions where the purchase options were exercised, SUTD argues there was a constructive delivery of the equipment and title passed to the purchaser at the time petitioner fulfilled the requirements of the agreement. Uniform Commercial Code Section 2401(2) states that unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes performance with respect to physical delivery of the goods. Section 2401(3)(a) and (b) provides that unless otherwise explicitly agreed, where delivery is to be made without moving the goods, if the seller is to deliver a document of title, title passes where such delivery is made, or if at the time of contracting the goods are identified and no documents are to be delivered, title passes at the time and place of contracting. The goods were clearly identified, paid for in full, and the only instrument conveying title was the sales invoices. SUTD further argues that there was no agreement presented which indicated petitioner was

obligated to make physical delivery at any time or place other than where the equipment was located at the time the sales were consummated. Therefore, the purchaser had the right to remove the equipment from petitioner's premises any time after making appropriate arrangements. The sales were recorded in the sales journal, and the inventory account relieved, with the cost recorded in the books. The sales amount, cost and profits were all included in petitioner's income tax returns filed for the same fiscal year in which the sales were made.

As to petitioner's returned merchandise argument, SUTD argues Regulation 1655 requires that the full sales price be refunded or credited to the customer. The recent check written to W--- C--- in the amount of \$250,893 for the return of the equipment represented by serial number 06YF00159 is less than the invoiced sales price of \$267,494 for that equipment. Therefore, the full purchase price was not refunded. As to the lease transaction involving the first piece of equipment (serial number 063X08095), the requirements of the regulation also have not been satisfied because the equipment purchased in the second transaction (063X09139) sold for more than the amount credited (\$176,000).

Analysis and Conclusions

As to whether or not tax is due on lease receipts, we agree with petitioner. The chief characteristic of renting or leasing is the giving up of possession to the hirer, so that the hirer and not the owner uses and controls the rented property. (Entremont v. Whitsell (1939) 13 Cal.2d 290, 295; California Civil Code Sections 1925 and 1955.) This is consistent with Revenue and Taxation Code Section 6006.1 which provides that the granting of possession of tangible personal property by a lessor to a lessee is a continuing sale. Although Regulation 1628(b)(3)(B) does provide that a sale by lease does occur even where there is a right to possession, it must be kept in mind this portion of the regulation is limited in its purpose. That purpose is to determine whether or not transportation charges should be included in the lessor's gross receipts. Therefore, this rule only applies in a situation where there has in fact been a delivery.

As to the two pieces of equipment which SUTD argues were taxable transactions (serial numbers 06YF00159 and 063X09139), we agree with petitioner that these transactions did not amount to sales. Revenue and Taxation Code Section 6006(a) defines a "sale" to mean and include any transfer of title or possession of tangible personal property for a consideration. Here, it is undisputed that petitioner never transferred possession to either W--- C--- or its related entity, M--- R---. Uniform Commercial Code Section 2401 provides the necessary guidelines in determining whether or not there was a passage of title. This section provides that title passes to the buyer "in any manner and on any conditions explicitly agreed upon by the parties". However, where there is no contract provision for passage of title (such as here), once the goods are identified, the passage of title depends on the type of performance required of the seller; i.e., whether shipment or delivery of the goods is required, or delivery is to be made without moving the goods. Where the goods must be moved, title passes to the buyer at the time and place at which the seller completes its performance with reference to physical delivery of the goods.

Here, although SUTD argues otherwise, I find that petitioner was required to deliver the equipment to either W--- C--- or M--- R---. At the bottom of the invoice relating to the equipment identified by serial number 06YF00159 (Exhibit 2), it specifically states “no sales tax out of state delivery”. The invoice relating to the equipment represented by serial number 063X09139 (Exhibit 3) specifically states “out of state (see Statement of Fact)”. This statement is apparently referencing the document dated June 5, 1990 (Exhibit 1) which indicates the equipment was intended to be delivered to Oregon, and petitioner would be provided with a bill of lading. This document, along with the comments in each invoice, clearly indicates petitioner was required to make delivery, and delivery had not yet been made. Accordingly, since there was no transfer of title or possession, there was no sale.

Because of the finding that petitioner is entitled to relief as to all three transactions, the remaining contention relating to returned merchandise will not be further considered. If, in a Request for Reconsideration, SUTD can point to further evidence or arguments to support its position, and reconsideration is granted, the remaining issue will be determined.

Recommendation

Grant the petition.

Lucian Khan, Staff Counsel

Date

Attachments: Exhibits 1-3